

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1948.

No. 668

THE UNITED STATES, PETITIONER,

vs.

HELEN W. BENEDICT and FRANK B. SMITH,
as Trustees, *et al.*, etc.

ON PETITION FOR WRIT OF CERTIORARI TO
THE COURT OF CLAIMS

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1 In the Court of Claims of the United States

No. 48463.

HELEN W. BENEDICT and FRANK B. SMITH, as Trustees, and
LELAND E. STOWELL and UNITED STATES TRUST COMPANY
OF NEW YORK as Successor Trustees under the Will of
JOHN E. ANDRUS, Deceased, PLAINTIFFS,

against

UNITED STATES OF AMERICA, DEFENDANT.

Petition—Filed Jan. 5, 1948.

To THE HONORABLE THE COURT OF CLAIMS:

The above-named plaintiffs complain of the above-named defendant and allege as follows:

1. Plaintiff Helen W. Benedict resides at Yonkers, New York; plaintiff Frank B. Smith resides at Ocean Grove, New Jersey; and plaintiff Leland A. Stowell resides at Scarsdale, New York. Plaintiff United States Trust Company of New York is a corporation duly organized and existing under the laws of the State of New York, maintaining its principal office at 45 Wall Street, New York, New York.

2. Plaintiffs are the duly appointed, qualified and acting trustees of a trust created under the will of John E. Andrus, who died a resident of the State of New York on December 26, 1934. A duly authenticated copy of the record of plaintiffs' appointment is attached hereto, marked Exhibit A and made a part hereof.

3. On or about July 7, 1944 plaintiffs filed in the office of the Collector of Internal Revenue for the Second District of New York a fiduciary income tax return on United States Treasury Form 1041 for the fiscal year ended April 30, 1944 and paid income taxes to the said Collector in respect of the liability for such fiscal year on July 7, 1944 and March 24, 1947 in the total amount of \$5,480.35.

4. This suit is brought against the defendant, United States of America, pursuant to Section 24(20) of the Judicial Code of the United States.

5. This action arises under the laws of the United States provided for internal revenue, as hereinafter more fully appears.

6. On or about June 24, 1947 plaintiffs filed with the Collector of Internal Revenue for the Second District of New York a claim for refund of income taxes paid in respect of the fiscal year ended April 30, 1944 in the amount of \$5,157.41.

7. Six months have elapsed since the filing of the claim for refund aforesaid, and said claim has not been acted upon by the Commissioner of Internal Revenue or any other official of defendant, nor has the sum demanded been refunded or credited to plaintiffs.

8. Under the provisions of the trust created by decedent's will referred to in paragraph 2 herein, forty-five per cent (45%) of the net income of the trust estate was directed to be paid to Surdna Foundation, Inc., a corporation organized and existing under the laws of the State of New York exclusively for charitable purposes, payments to which have been recognized by the Commissioner of Internal Revenue as deductible under the provisions of Section 162(a) of the Internal Revenue Code.

9. Pursuant to the provisions of the trust described in paragraph 8 herein, forty-five per cent (45%) of the net income of the trust for the fiscal year ended April 30, 1944, including \$27,168.31 for its total capital gains, was permanently set aside for Sundra Foundation, Inc.

10. In preparing plaintiffs' income tax return for the fiscal year ending April 30, 1944 (referred to in paragraph 3 herein), only fifty per cent (50%) of said \$27,168.31 capital gains was deducted in computing net income, the deduction claimed in the return being in the amount of \$13,435.83.

11. Under Section 162(a) of the Internal Revenue Code, all of the capital gains permanently set aside by plaintiffs for Surdna Foundation, Inc., without any percentage or other limitations, were deductible in computing plaintiffs' net income. Allowance of this deduction in the proper amount, to wit, \$27,168.31, reduces plaintiffs' income tax liability for the fiscal year ended April 30, 1944 by the amount of \$5,157.41.

12. Plaintiffs have not assigned or transferred any part of the claim for refund upon which this action is based and are justly entitled to recover the amount claimed below.

13. Plaintiffs, and each of them, have at all times borne true allegiance to the Government of the United States and have not in any way voluntarily aided, abetted or given encouragement to rebellion against said Government.

14. The grounds for this action were set forth in the plaintiffs' refund claim.

4 WHEREFORE, the plaintiffs demand judgment against the defendant in the sum of \$5,157.41 with interest as provided by law from July 7, 1944.

RATHBONE, PERRY, KELLY & DRYE,
By JOHN W. DRYE, JR.
Attorneys for Plaintiffs
Office and P. O. Address
No. 70 Broadway,
New York City, N. Y.

5 Duly sworn to by Helen W. Benedict, et al.
jurats omitted in printing.
(all in italics)

7 Exhibit "A" to Petition.

No. 19752

Form 151

THE PEOPLE OF THE STATE OF NEW YORK,

To all to whom these presents shall come or may concern,

SEND GREETING:

KNOW YE, That we, having inspected the records of our Surrogate's Court in and for the County of Westchester, do find that on the 3rd day of March, in the year One thousand nine hundred and forty-two by said Court, Letters of Trusteeship under the will of

..... JOHN E. ANDRUS
deceased, were granted unto LELAND E. STOWELL in conjunction with UNITED STATES TRUST COMPANY OF NEW YORK as Successor Trustee, HELEN W. BENEDICT and FRANK B. SMITH to whom similar Letters were heretofore issued as Trustees of the trusts created in and by said Will, to wit: Paragraph Fourth (All assets of the trusts shall be retained in the sole and exclusive custody of the United States Trust Company of New York) and that it does not appear by said records that said letters have been revoked.

IN TESTIMONY WHEREOF, we have caused the seal of office of the Surrogate's Court of the County of Westchester to be hereunto affixed.

Witness, Honorable CHARLES H. GRIFFITHS, Surrogate of our said County in the City of White Plains, the 23rd day of December, in the year of our Lord one thousand nine hundred and forty-seven.

ELMER L. FINGAR

(Seal)

Clerk of the Surrogate's Court

9

General Traverse

Filed January 9, 1948.

And now comes the Attorney General, on behalf of the United States, and answering the petition of the claimant herein, denies each and every allegation therein contained; and asks judgment that the petition be dismissed.

(s) THERON L. CAUDLE,

E. B. D.

Assistant Attorney General.

Argument and Submission of Case

On October 6, 1948, the case was argued and submitted on merits by Mr. Theodore Pearson for plaintiffs and by Mrs. Elizabeth B. Davis for defendant.

11 *Special Findings of Fact, Conclusion of Law and
Opinion of the Court by Littleton, J. Dissenting
Opinion by Madden, J.*

Filed January 3, 1949.

Mr. Theodore Pearson for the plaintiffs.

Mr. William H. Harrar and Messrs. Rathbone, Perry, Kelley & Drye were on the brief.

Mrs. Elizabeth B. Davis, with whom was Mr. Assistant Attorney General Theron Lamar Caudle, for the defendant. Mr. Andrew D. Sharpe and Mr. Lee A. Jackson were on the brief.

The terms of a will creating a trust required that 45% of the income of the trust be paid to a charitable corporation, and pursuant thereto such part of the total income of the trust for 1944 (after expenses), including long-term capital gains, was permanently set aside for such charitable use. The question is whether the trust is entitled under Section 162 (a) (26 U. S. C. 1946 Ed., § 162), to deduct on the fiduciary return 45% of the full amount of the capital gains of \$60,374.01 so set aside, or only 50% thereof in view of Section 117 (a) (4) and (b), which provides, for the

purpose of computing taxable net income, that only 50% of long-term capital gains shall be included in determining net capital gain and net income, subject to the tax.

12

SPECIAL FINDINGS OF FACT

1. The plaintiffs are trustees of the trust created under the will of John E. Andrus, who died a resident of the State of New York on December 26, 1934. A fiduciary income tax return was filed for the fiscal year ended April 30, 1944, on July 10, 1944, showing a net income taxable to the fiduciary of \$16,421.58 and tax due of \$5,297.57 which plaintiffs paid July 11, 1944. Thereafter, upon examination of the return, the Commissioner of Internal Revenue determined the tax payable on the net income of \$16,421.58 to be \$5,480.35, and asserted a deficiency of \$182.78 which plaintiffs paid together with interest of \$23.97, on March 15, 1947.

2. Under the provisions of the trust provided under the will, 45% of the plaintiffs' income for the fiscal year 1944 was permanently set aside for the Surdna Foundation, Inc., a corporation organized, under the laws of the State of New York, exclusively for charitable purposes, payments to which are deductible as contributions under Section 23 (o) of the Internal Revenue Code. The will provided, so far as here material, as follows:

FOURTH: All the rest, residue and remainder of my estate, real, personal or mixed, of any kind or nature and wheresoever situated, I give, devise and bequeath to * * * IN TRUST, * * * to collect and receive the rents, issues and profits thereof (hereinafter called "income") and after first paying therefrom all proper expenses to divide the net income into one hundred (100) parts, and to pay the same quarterly or at such other intervals as shall be convenient in the administration of the trust as follows:

Forty-five (45) parts thereof to SURDNA FOUNDATION, INC., a corporation organized and existing under the laws of the State of New York.

On the termination of the trust, I direct my Trustees to transfer, convey, assign and set over forty-five (45) parts of the capital of the trust as it shall then exist to SURDNA FOUNDATION, INC., and the remaining fifty-five (55) parts to the persons receiving the income therefrom at the termination of the trust, in the same pro-

portions as they are then receiving the income thereof, and I give, devise and bequeath the same accordingly.

FIFTH: I hereby authorize and empower my Trustees to hold, sell, mortgage, exchange, lease, dispose, of, invest, reinvest manage operate and control the principal of the trust property in whatever form the same may at any time be during the continuation of the trust as fully and freely as I could have managed and disposed of the same if living without regard to any restrictions to which trustees are ordinarily subject, statutory or otherwise. * * *

3. The gross income of the trust of 1944, other than gain from capital assets, was \$270,169.92. Plaintiffs had deductions of \$29,602.19, leaving a balance of \$240,567.73, which amount was also the amount currently distributable to beneficiaries. Plaintiffs had a gross long-term capital gain of \$60,374.01, of which \$30,187.01 was taken into account in computing taxable net income; said \$30,187.01 was reduced by a 1942 carry-over of \$329.60, leaving a balance of \$29,857.41. In preparing the fiduciary return, plaintiffs deducted \$13,435.83, 45% of the amount of \$29,857.41, which represented Surdna Foundation's portion of said \$29,857.41. Surdna Foundation actually got 45% of the \$60,374.01. The computation made by the trustees left the amount of \$16,421.58, which they reported on the return as "Net Taxable Gain Taxable to Trustee," said amount being the net income shown by the return, and the tax of \$5,297.57 was computed thereon, as set forth above.

4. On June 24, 1947, plaintiffs filed a claim for refund of the tax paid for 1944 in the amount of \$5,157.41. In the statement supporting the refund claim, the ground upon which refund is sought is set forth as follows:

45% of the income of the Trustees herein, under the will of the decedent John E. Andrus, is required to be paid or permanently set aside to Surdna Foundation, Inc., a New York charitable corporation. In computing the net income of the Trustees for the year ended April 30, 1944, instead of deducting \$27,168.31 representing 45% of the income so paid or permanently set aside to Surdna Foundation, only \$13,435.83 was deducted, the latter amount having been based upon the portion of capital gains taken into account.

The Tax Court of the United States on August 16, 1946, determined in the case of the Trust under agreement, dated December 30, 1921, by John E. Andrus de-

ceased (Trust #1) 7 T. C. #70, that the entire amount so paid or permanently set aside is deductible under Section 162 (a) of the Internal Revenue Code. The provisions of the Trust under the will of John E. Andrus are substantially identical with those of the Trust considered by the Tax Court in the above decision, insofar as the matter covered by the refund claim herein is concerned.

On the authority of said decision, request is made for the allowance of a deduction under Section 162 (a) of the Code of \$27,168.31 in computing our net income requiring the refund claimed herein.

The claim had not been acted upon by the Commissioner of Internal Revenue prior to the filing of the petition herein nor has any portion of the sum demanded been refunded or credited to plaintiffs.

5. If the allowable deduction for charitable contributions is to be calculated on the basis of 45% of the aforesaid \$29,857.41, judgment must be entered for the defendant. If said deduction for charitable contributions is to be calculated on the basis of 45% of the aforesaid total gain of \$60,374.01, the amount of the allowable deduction would be \$27,168.31 and the allowance of such amount as a deduction would result in an overpayment of income tax for the year ended April 30, 1944, in the amount of \$4,962.43.

CONCLUSION OF LAW

Upon the foregoing special findings of fact which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiffs are entitled to recover \$4,962.43, with interest as provided by law.

It is therefore adjudged and ordered that plaintiffs recover of and from the United States four thousand nine hundred sixty-two dollars and forty-three cents (\$4,962.43) together with interest at six percent per annum on \$4,755.68 from July 11, 1944, and on \$206.75 from March 15, 1947, until such date as the Commissioner of Internal Revenue may determine in accordance with Section 117 (b) of the Judicial Code, as amended.

OPINION

LITTLETON, Judge, delivered the opinion of the court:

Under the terms of the fourth article of the will of John E. Andrus, creating a trust, 45% of the income of the trust, including the income, gains and profits

derived from the sale or exchange of property of the trust, was required to be paid to the Surdna Foundation, Inc., a charitable corporation. The balance of 55% of such income was to be divided into certain stated amounts and paid to ten individuals (finding 2). As shown in finding 3, the trust had a gross income for the fiscal year ending April 30, 1944, not including long-term capital gains, of \$270,169.92, from which there were allowable deductions of \$29,602.19, leaving a net balance of \$240,567.73, which was a part of the income of the trust distributable to the beneficiaries named under the fourth article of the will. In addition, the trust had further income consisting of gains and profits totaling \$60,374.01, which amount was likewise distributable, derived from the sale of certain properties of the trust. These properties consisted of capital assets within the meaning of Section 117 (a) and (b), Internal Revenue Code (26 U. S. C. 1946 Ed., § 117), and had been held by the trust for more than six months. After deduction of expenses, forty-five percent of the entire income of the trust of \$300,941.74 was paid to or permanently set aside by the trustees for the Surdna Foundation.

The question presented is whether the trust is entitled, in computing the net income upon which it may be taxable, to deduct, under Sections 22 and 162, U. S. C. 1946 Ed., Title 26, 45% of the full amount of the gains and profits of \$60,374.01, or only forty-five percent of one-half thereof or \$30,187.01 by reason of the "Capital Gains" provisions of Section 117 (a) and (b), U. S. C. Title 26. The pertinent provisions of the Internal Revenue Code relating to the question are set forth below.¹

¹ SEC. 22. GROSS INCOME

(a) GENERAL DEFINITION.—"Gross income" includes gains, profits, and income derived from * * * sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; * * *

(f) DETERMINATION OF GAIN OR LOSS.—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS

(a) COMPUTATION OF GAIN OR LOSS.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain * * *.

SEC. 117. CAPITAL GAINS AND LOSSES

(a) DEFINITIONS.—As used in this chapter—

16 The defendant says with respect to the gains and profits of \$60,374.01, that the trust is entitled to a deduction for charitable contributions of only 45% of \$29,857.41 thereof (\$30,187.01 less a carry-over of \$329.60) by reason of the provisions of Section 117 (a) and (b), which section, defendant insists, defines "gross income" in the case of a "long-term capital gain" for the purpose of the deduction provided in Section 162, and limits the definition of "gross income" and "gain from the sale of property," as set forth in Sections 22 (a) and (f), 162 (a) and 111 (a), respectively. We cannot agree. In our opinion the defendant's attempt to limit the deduction for charitable purposes of "any part of the gross income, without limitation," in part to *net income*, represents a narrow and strained construction of the several sections mentioned which, we think, was not in the mind of Congress or intended by it when the capital gains provisions of Section 117 were enacted. We think the principle announced in *Helvering v. Bliss*, 293 U. S. 144, and *United States v. Pleasants*, 305 U. S. 357, with reference to the intention of Congress not to place further limitations on charitable contributions and the limited purpose intended to be accomplished in connection with taxation of capital gains and deduction of capital losses, is applicable here and supports the plaintiffs' claim. Sections 22 and 111,

(Footnote 1 continued)

(4) LONG-TERM CAPITAL GAIN.—The term "long-term capital gain" means gain from the sale or exchange or a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income:

* * *

(b) PERCENTAGE TAKEN INTO ACCOUNT.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

SEC. 162. NET INCOME

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 (o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, as during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes * * *

supra, define gains derived from the sale or disposition of property including capital assets. These gains, 17 as so defined, must be reported in the return and they are taxable as income in whole or in part under the capital gains provisions of Section 117, depending upon the length of time the assets had been held. The allowance under 162 (a) is out of total income rather than net taxable income. The liberal attitude of Congress as expressed in Section 117 with respect to the taxation of a capital gain by including only one-half thereof in net income, under certain circumstances, was not intended, in our opinion, to modify the definition of gross income. In this case the trust had a gain of \$60,374.01 within the meaning and under the plain language of Sections 22 and 111, and, for the purpose of the deduction provided in Section 162 (a), that gain was a part of the gross income of the trust. The percentage limitation, set forth in Section 117, was enacted for the sole purpose of giving lighter tax treatment to certain capital gains and ought not to be read into Section 162 (a) for the purpose of limiting the amount of the deduction for charitable contributions. The original purpose intended by the capital gains provisions was retained. Section 162 (a), like Sections 22 and 111, deals with gross income and total gains and profits for the taxable year out of which the charitable contributions are made. Section 117 deals only with *net* capital gain, *net* capital loss and *net* income which is to be subjected to the tax. The total gain of the taxpayer is nevertheless the gain defined by Sections 22 and 111, and must be considered and reported as gross income in the first instance. This must be true because Section 117 taxes the entire gain as net income under certain circumstances.

The total gain must be classified in the computation of *net* taxable income according to the periods through which the various assets have been held and this classification is made solely for the purpose of the special tax on capital gains, based on the adventitious point of how long the asset had been owned and held by the taxpayer before it was disposed of. *Lockhart v. Commissioner*, 1 T. C. 804, 807.

In our opinion the ordinary and natural meaning of the language of Sections 22 and 111, *supra*, support the views we have expressed above, and we cannot find in the language of Section 117, or the reports of the Congressional committees thereon, any support for the position that Congress intended thereby to limit or

modify the term "gross income," as used in Sections 22 and 162 (a), for the purpose of determining the amount of the deduction for charitable contributions by estates or trusts. In our opinion the decision of the Tax Court in *John E. Andrus Trust No. 1 v. Commissioner*, 7 T. C. 573, which involved the same question we have here, was correct, and we are unable to concur in the decision of the Court of Appeals in *Commissioner v. Central Hanover Bank & Trust Co.*, 163 Fed. (2d) 208, 210, in which the court said:

Accordingly the amount of long-term capital gain not taken into account under § 117 does not constitute gross income of the trust under § 22 (a). And, since the deduction allowed by § 162 (a) is restricted to payments made out of "gross income," the deduction here must be limited to that portion of the charitable gift which was made out of statutory gross income.

We cannot escape the conclusion that the above holding limits the deduction for charitable contributions in part to net income. In our opinion Section 117 (a) (4) recognizes as gross income the entire gain defined by Sections 22 and 111, and then classifies such gain as a "long-term capital gain" for special treatment in computing net income only if the asset from which such total or gross gain was derived, had been held for more than 6 months.

Plaintiffs are entitled to recover, and, under finding 5, judgment will be entered in their favor for \$4,962.43 with interest as provided by law. It is so ordered.

HOWELL, Judge; WHITAKER, Judge; and JONES, Chief Judge, concur.

DISSENTING OPINION

MADDEN, Judge, dissenting:

I am unable to agree with the decision of the Court. My reasons are, in general, those given by the Court in *Commissioner v. Central Hanover Bank and Trust Co.*, 163 Fed. (2d) 208.

At a Court of Claims held in the City of Washington on the 3rd day of January, A. D., 1949, judgment was ordered to be entered as follows:

Upon the special findings of fact which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiffs are entitled to recover.

IT IS THEREFORE ADJUDGED AND ORDERED that plaintiffs recover of and from the United States four thousand nine hundred sixty-two dollars and forty-three cents (\$4,962.43) together with interest at six percent per annum on \$4,755.68 from July 11, 1944, and on \$206.75 from March 15, 1947, until such date as the Commissioner of Internal Revenue may determine in accordance with Section 117 (b) of the Judicial Code, as amended.

21 Clerk's Certificate to foregoing transcript omitted
in printing.

Supreme Court of the United States

Order allowing certiorari—Filed May 2, 1949

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ. The case is transferred to the summary docket.